

# Do Labor Markets Discipline? Evidence from RMBS Bankers

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# Starting point: Widespread RMBS fraud

## ► Academic Evidence

- Inflated appraisals, unreported second liens, owner occupancy, income and asset overstatement (Pikorski, Seru, and Witkin 2015; Jiang, Nelson, and Vytlačil 2014; Garmaise 2013; Ben-David 2013; Mian and Sufi 2016)
- 48% of RMBS loans show appraisal overstatements, unreported second liens, or misreported owner occupancy (Griffin and Maturana 2016)

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## ► 7 DOJ settlements (11 banks)

- 4,500+ securities (80% of RMBS universe)
- Detailed statements of facts from loan-level document reviews

## ► Due diligence

- Each bank received detailed due diligence on their loans
- See Clayton in FCIC report

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## ► Total of \$137+ billion in fines pertaining to mortgage abuses in the run-up to the financial crisis, involving most large banks, with admissions of wrongdoing

# Economic and policy motivation

- ▶ Economic motivation

- ▶ Longstanding prediction that firms and markets will discipline individual employees (Becker 1968; Posner 1977; Elzinga and Breit 1976; Fama 1980)
  - ▶ Yet, the law literature is mostly skeptical (Coffee 1980; Polinsky and Shavell 1993; Rakoff 2014)
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## ▶ Policy motivation

- ▶ Economic doctrine of punishment used by DOJ
  - \* Deferred and non-prosecution agreements
- ▶ Controversial in the legal and policy communities
  - \* E.g., Jed Rakoff (US District Judge, Southern District of NY, Adjunct at Columbia): Rejected a \$285 million settlement between the SEC and Citigroup
- ▶ More generally, widespread public anger and calls for personal accountability

# Main question

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- ▶ More specifically:
  1. **Did their firms discipline them?** Did they leave and/or were they passed over for promotion?
  2. **Did the labor market discipline them?** Were they able to obtain good jobs at other firms?
  3. **Did they stay in finance?**
  4. **How did outcomes vary in the cross section?** By firm, seniority, and involvement in specific deals



# Data and measures

- ▶ Sample of **715 RMBS bankers** in 2004-2006 from two sources
  - ▶ Signers of SEC documents associated with RMBS deals (386 individuals, 3,331 deals)
  - ▶ RMBS bankers employed by top-18 underwriters (329 individuals)
    - \* Identified by job description keywords on a large professional networking platform
  - ▶ Compare RMBS bankers to non-RMBS (CMBS and non-mortgage ABS) bankers from same sources
  - ▶ Also analyze 2006 American Securitization Forum (ASF) attendees and compare RMBS bankers to investment bankers

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  - ▶ Also analyze 2006 American Securitization Forum (ASF) attendees and compare RMBS bankers to investment bankers
- ▶ Biographical information from public profiles on professional networking platform and other biographical sources
- ▶ Outcomes of interest:
  - ▶ Continued employment with original underwriter
  - ▶ Employment with another top underwriter
  - ▶ Promotions (with original employer) and job upgrades (at other companies)
  - ▶ Graduate school

# Data summary

## Main samples

	RMBS bankers			Non-RMBS bankers		
	Full sample	Signers	Non signers	Full sample	Signers	Non signers
Age	37	42	32	39	45	33
MBA	21.3	25.4	16.4	31.0	35.1	26.5
Top 25 Alma Mater	24.1	25.9	21.9	30.0	26.6	33.7
Director or above	60.9	87.8	20.3	66.1	87.8	39.0
Vice-President	18.4	10.4	30.5	17.8	9.7	28.0
Associate	8.1	1.8	17.6	9.2	2.5	17.7
Analyst	12.6	0.0	31.6	6.8	0.0	15.4
Employed at top-18 underwriter (%)	78.2	59.6	100.0	64.9	32.6	100.0
Number of individuals	715	386	329	613	319	294

# Were RMBS bankers disciplined?

- ▶ How did RMBS bankers fare?
  - ▶ As of 2011, 26% employed by same firm, 42% employed by a top bank, and 47% upgraded
  - ▶ As of 2016, 85% still employed in finance

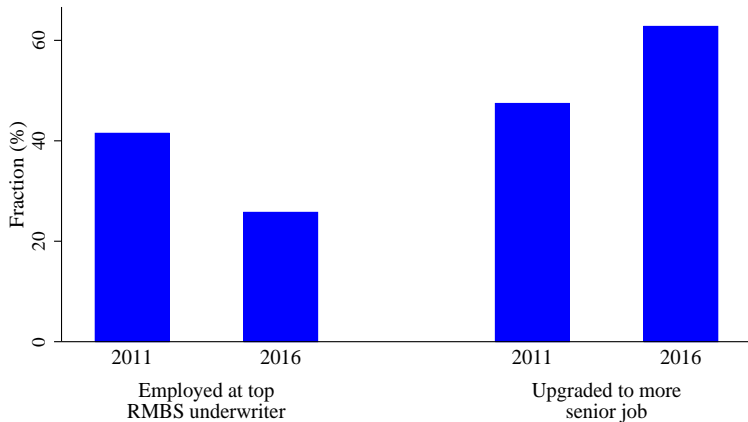
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  - ▶ Exception: Some evidence of internal discipline for junior bankers

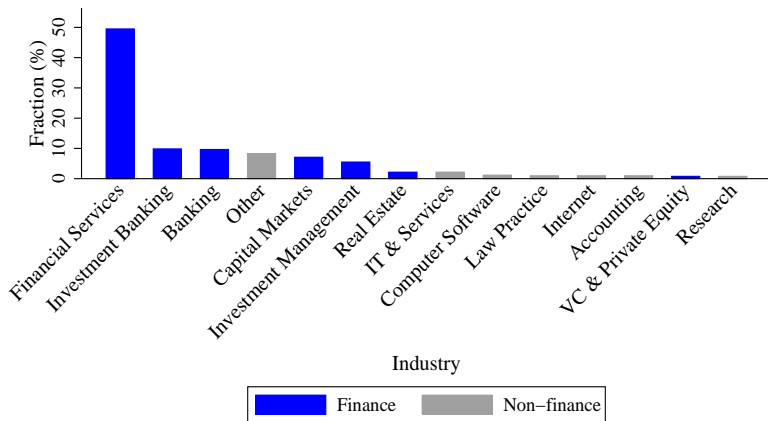
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  - ▶ Exception: Some evidence of internal discipline for junior bankers
- ▶ Did discipline vary across banks?
  - ▶ Some evidence of discipline at smaller banks
  - ▶ No discipline at any top banks, even at banks that failed

## How did RMBS bankers do?



# Did RMBS bankers stay in finance?

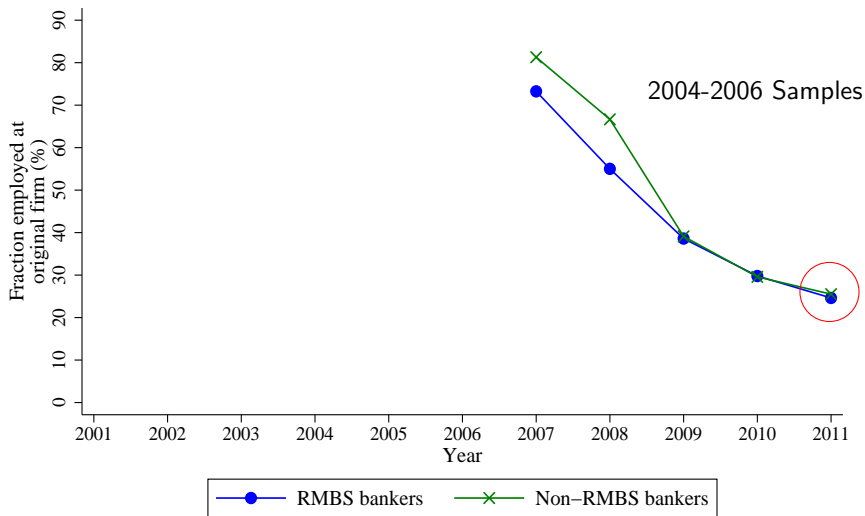




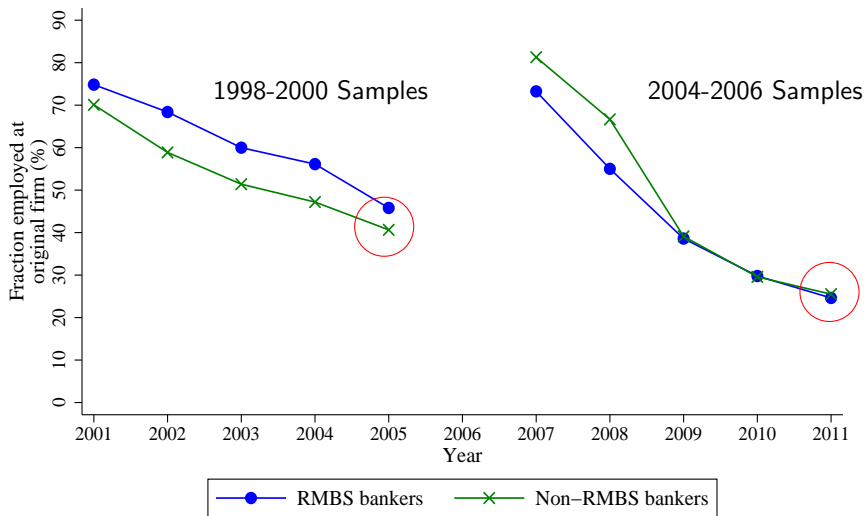
# Were RMBS bankers disciplined?

	Employed at Original Firm		Employed at Top Underwriter	
	(1)	(2)	(3)	(4)
Mean	0.266	0.267	0.409	0.403
RMBS	0.026 (0.019)	0.037 (0.055)	0.043 (0.040)	0.077 (0.078)
RMBS×Senior		-0.025 (0.068)		-0.053 (0.087)
Age	-0.009*** (0.003)	-0.009*** (0.003)	-0.006* (0.003)	-0.008*** (0.003)
MBA	-0.009 (0.053)	-0.009 (0.055)	-0.034 (0.047)	-0.027 (0.048)
Top 25 Alma Mater	-0.069*** (0.026)	-0.060** (0.026)	-0.069** (0.031)	-0.065** (0.033)
Bank Fixed Effects	Yes	Yes	Yes	Yes
Position Level Fixed Effects	Yes	Yes	Yes	Yes
Observations	957	844	957	844
Adjusted R-Squared	0.085	0.089	0.057	0.064

# Diff-in-diff representation



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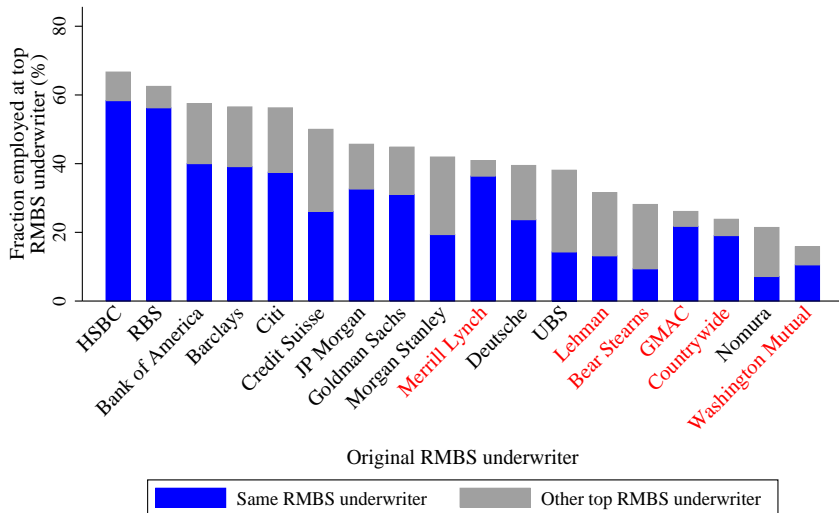
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	Employed at Original Firm			Employed at Top Underwriter		
	(1)	(2)	(3)	(4)	(5)	(6)
Mean	0.250	0.314	0.317	0.424	0.525	0.507
RMBS × Post			-0.049 ( 0.054)			-0.004 ( 0.063)
RMBS	0.041 (0.029)		0.099*** (0.032)	0.088 (0.056)		0.098*** (0.034)
Post		-0.207*** (0.054)	-0.147*** (0.040)		-0.226*** (0.057)	-0.220*** (0.044)
Age	-0.008** (0.003)	-0.002 (0.003)	-0.009*** (0.002)	-0.004 (0.004)	-0.002 (0.003)	-0.006*** (0.002)
MBA	0.062 (0.047)	-0.125** (0.055)	-0.001 (0.042)	0.037 (0.040)	-0.068 (0.044)	-0.008 (0.037)
Top 25 Alma Mater	-0.137*** (0.041)	-0.212*** (0.050)	-0.150*** (0.035)	-0.125*** (0.038)	-0.157*** (0.045)	-0.118*** (0.036)
Bank FE	Yes	Yes	Yes	Yes	Yes	Yes
Position Level FE	Yes	Yes	Yes	Yes	Yes	Yes
ABS Sample	Yes	No	Yes	Yes	No	Yes
1998-2000 Sample	No	Yes	Yes	No	Yes	Yes
Observations	623	484	992	623	484	992
Adjusted R-Squared	0.067	0.102	0.102	0.061	0.093	0.095

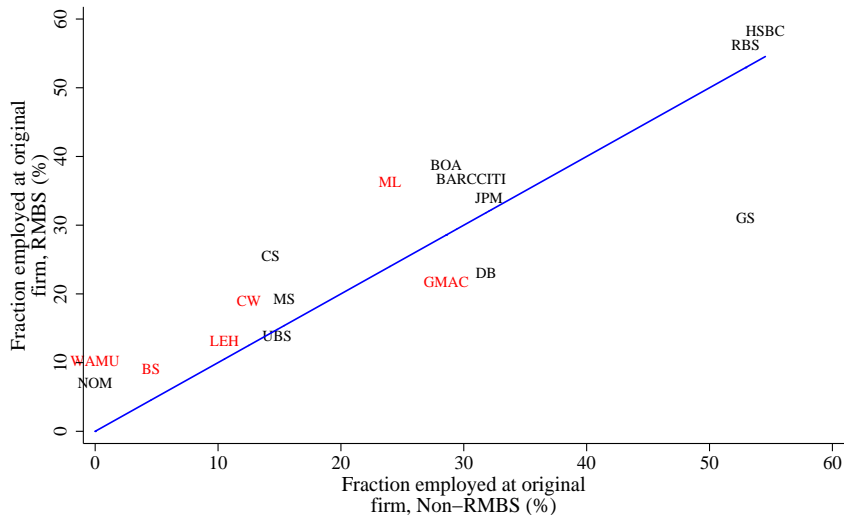
# Were junior RMBS bankers disciplined? (diff-in-diff)

	Employed at Original Firm			Employed at Top Underwriter		
	(1)	(2)	(3)	(4)	(5)	(6)
Mean	0.200	0.247	0.220	0.381	0.460	0.428
RMBS × Post			-0.255*** ( 0.073)			-0.104 (0.114)
RMBS	0.023 (0.058)		0.276*** (0.046)	0.091 (0.083)		0.228*** (0.070)
Post		-0.219*** (0.061)	0.064 (0.067)		-0.213*** (0.068)	-0.101 (0.108)
Age	-0.005 (0.005)	0.003 (0.005)	-0.001 (0.005)	-0.001 (0.007)	0.000 (0.005)	-0.002 (0.005)
MBA	0.083 (0.108)	-0.068 (0.099)	-0.025 (0.082)	0.054 (0.094)	-0.030 (0.089)	-0.014 (0.090)
Top 25 Alma Mater	-0.080** (0.039)	-0.145** (0.058)	-0.064* (0.036)	-0.102 (0.073)	-0.064 (0.102)	-0.008 (0.057)
Bank FE	Yes	Yes	Yes	Yes	Yes	Yes
Position Level FE	Yes	Yes	Yes	Yes	Yes	Yes
ABS Sample	Yes	No	Yes	Yes	No	Yes
1998-2000 Sample	No	Yes	Yes	No	Yes	Yes
Observations	210	174	313	210	174	313
Adjusted R-Squared	0.004	0.122	0.054	0.028	0.095	0.063

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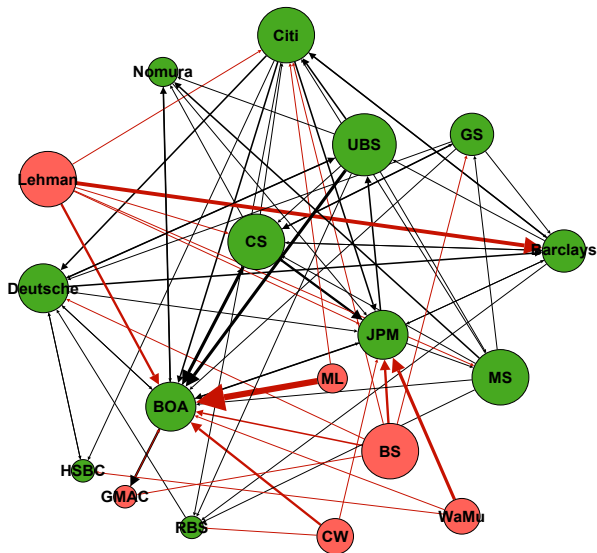


## Did discipline vary across banks?

	Employed at Original Firm			Employed at Top Underwriter	
	(1)	(2)	(3)	(4)	(5)
Mean	0.320	0.266	0.266	0.409	0.409
RMBS	-0.011 (0.029)	0.022 (0.023)	0.043** (0.018)	0.071 (0.048)	0.069* (0.042)
RMBS×Small	-0.152** (0.060)				
RMBS×Acquired		0.014 (0.037)		-0.112* (0.058)	
RMBS×I-Bank			-0.037 (0.042)		-0.056 (0.078)
Small Underwriter	-0.021 (0.028)				
Sample	Full Sample	Top Underwriters	Top Underwriters	Top Underwriters	Top Underwriters
Controls	Yes	Yes	Yes	Yes	Yes
Bank FE	No	Yes	Yes	Yes	Yes
Position Level FE	Yes	Yes	Yes	Yes	Yes
Observations	1,328	957	957	957	957
Adjusted R-Squared	0.047	0.084	0.085	0.058	0.057



# RMBS banker movement 2006-2011



# Why weren't RMBS bankers disciplined?

- ▶ **Only the most culpable bankers were disciplined?**
  - ▶ No evidence of discipline for MDs or prospectus signers
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- ▶ In sum: Banks chose not to discipline RMBS bankers
  - ▶ Discipline not in shareholder's interest?
  - ▶ Agency conflicts?

# Conclusion

- ▶ RMBS bankers fared reasonably well
  - ▶ As of 2011, 26% employed by same bank, 42% employed by a top underwriter, and 47% upgraded to a more senior position
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  - ▶ And evidence contradicts many leading explanations
  - ▶ Lack of discipline likely due to profit maximization or agency problems

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  - ▶ And evidence contradicts many leading explanations
  - ▶ Lack of discipline likely due to profit maximization or agency problems
- ▶ **Implications:**
  - ▶ Civil corporate penalties ineffective (at least in this setting)
  - ▶ Incentive to participate in fraud
    - \* Keep your head down, do your job, don't ask questions, things will work out?